

UNITED STATES  
FEDERAL RESERVE BOARD OF GOVERNORS  
Washington, DC 20551

**FORM 10-QSB**

QUARTERLY REPORT UNDER SECTION 13 OR 15 (d) OF  
THE SECURITIES EXCHANGE ACT OF 1934

For Quarterly Period Ended: March 31, 2005

OR

TRANSITION REPORT UNDER SECTIONS 13 OR 15 (d) OF  
THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number: \_\_\_\_\_

**MONARCH BANK**

\_\_\_\_\_  
(Exact name of small business issuer as specified in its charter)

Virginia

\_\_\_\_\_  
(State or other jurisdiction of  
incorporation or organization)

54-1896433

\_\_\_\_\_  
(I.R.S. Employer  
Identification No.)

750 Volvo Parkway, Chesapeake, Virginia

\_\_\_\_\_  
(Address of principal executive offices)

23320

\_\_\_\_\_  
(Zip Code)

(757) 222-2100

\_\_\_\_\_  
(Issuer's telephone number)

N/A

\_\_\_\_\_  
(Former name, former address and former fiscal year, if changed since last report)

Number of shares of common stock of registrant outstanding at May 11, 2005: 2,406,379

**MONARCH BANK**  
**FORM 10-QSB**  
**MARCH 31, 2005**

**INDEX**

<b>PART I.</b>	<b>FINANCIAL INFORMATION</b>	
Item 1.	Consolidated Statements of Condition as of March 31, 2005 and December 31, 2004	3
	Consolidated Statements of Income for the three months ended March 31, 2005 and 2004	4
	Consolidated Statements of Stockholders' Equity for the periods ended March 31, 2005 and 2004	5
	Consolidated Statement of Cash Flows for the periods ended March 31, 2005 and 2004	6
	Notes to Consolidated Financial Statements	7
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	11
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	18
Item 4.	Controls and Procedures	18
<b>PART II</b>	<b>OTHER INFORMATION</b>	
Item 1.	Legal Proceedings	19
Item 2.	Changes in Securities	19
Item 3.	Defaults Upon Senior Securities	19
Item 4.	Submission of Matters to Vote of Security Holders	19
Item 5.	Other Information	19
Item 6.	Exhibits and Reports on Form 8-K	19

**PART I - FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**Consolidated Balance Sheets**  
**Monarch Bank and Subsidiaries**

	<u>Unaudited</u> <u>March 31,</u> <u>2005</u>	<u>Audited</u> <u>December 31,</u> <u>2004</u>
<b>ASSETS:</b>		
Cash and cash equivalents:		
Cash and due from banks	\$ 4,889,260	\$ 4,853,400
Federal funds sold	537,413	375,398
Total cash and cash equivalents	5,426,673	5,228,798
Investment securities available-for-sale, at fair value	26,206,059	32,541,028
Investment securities held to maturity, at cost	1,100,000	500,000
Mortgages held for sale	3,071,097	4,157,133
Loans:		
Loans, net of unearned income	195,783,545	178,945,284
Less: allowance for loan losses	(1,977,000)	(1,804,000)
Loans, net	193,806,545	177,141,284
Interest receivable	770,496	637,573
Property and equipment, net	3,224,264	3,159,483
Restricted equity securities	1,985,555	2,350,155
Other assets	1,561,271	1,142,048
<b>Total assets</b>	<b>\$ 237,151,960</b>	<b>\$ 226,857,502</b>
<b>LIABILITIES:</b>		
Deposits:		
Noninterest-bearing	\$ 44,424,595	\$ 29,149,264
Interest-bearing	148,674,309	142,226,933
Total deposits	193,098,904	171,376,197
Borrowings:		
Federal Home Loan Bank advances	20,000,000	30,000,000
Other short-term borrowings	1,952,000	3,812,000
Total borrowings	21,952,000	33,812,000
Other liabilities	672,830	552,967
<b>Total liabilities</b>	<b>215,723,734</b>	<b>205,741,164</b>
<b>STOCKHOLDERS' EQUITY:</b>		
Preferred stock, \$5 par value, 2,000,000 shares authorized, none issued	-	-
Common stock, \$5 par value, 5,000,000 shares authorized, issued and outstanding 2,406,379 and 2,400,139 shares, respectively	12,031,895	12,000,695
Additional paid-in capital	8,512,668	8,478,868
Accumulated earnings	1,156,193	784,340
Accumulated other comprehensive loss	(272,530)	(147,565)
<b>Total stockholders' equity</b>	<b>21,428,226</b>	<b>21,116,338</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 237,151,960</b>	<b>\$ 226,857,502</b>

The accompanying notes are an integral part of these consolidated financial statements.

## Consolidated Statements of Income

### *Monarch Bank and Subsidiaries*

Unaudited

	3 Months Ended March 31,	
	2005	2004
<b>Interest income:</b>		
Interest and fees on loans	\$ 2,915,642	\$ 1,909,504
Interest on investment securities		
Taxable	142,197	163,742
Nontaxable	1,765	15,522
Interest on federal funds sold	5,511	14,163
Dividends on equity securities	15,475	13,388
Other interest income	1,752	1,343
Total interest income	3,082,342	2,117,662
<b>Interest expense:</b>		
Interest on deposits	882,678	707,868
Interest on borrowings	128,307	57,339
Total interest expense	1,010,985	765,207
<b>Net interest income</b>	2,071,357	1,352,455
<b>Provision for loan losses</b>	173,000	27,000
<b>Net interest income after provision for loan losses</b>	1,898,357	1,325,455
<b>Noninterest income:</b>		
Mortgage banking income	446,801	408,269
Service charges and fees	172,137	148,845
Gain (loss) on sale of investment securities	(10,841)	(16,454)
Other income (loss)	19,661	7,401
Total noninterest income	627,758	548,061
<b>Noninterest expenses:</b>		
Salaries and employee benefits	1,154,045	905,589
Occupancy expenses	145,340	116,263
Furniture and equipment expenses	118,521	105,924
Data processing services	111,944	167,980
Loan origination expenses	45,019	53,900
Advertising and marketing expenses	50,515	47,660
Professional fees	14,375	43,228
Virginia Franchise Tax	45,000	39,000
Stationery and supplies	38,297	32,935
Other	240,556	149,582
Total noninterest expenses	1,963,612	1,662,061
<b>Income before income taxes and minority interests</b>	562,503	211,455
<b>Minority interests in subsidiary's net income</b>	-	(7,453)
<b>Net income before income taxes</b>	562,503	204,002
<b>Income tax expense</b>	(190,650)	(69,361)
<b>Net income</b>	\$ 371,853	\$ 134,641
<b>Basic net income per share</b>	\$ 0.15	\$ 0.06
<b>Diluted net income per share</b>	0.15	0.05

The accompanying notes are an integral part of these consolidated financial statements.

Item 1. Financial Statements (Continued)

**Consolidated Statements of Changes in Shareholders' Equity**  
**Monarch Bank and Subsidiaries**

Unaudited

	Common Stock		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
	Shares	Amount				
<b>Balance - December 31, 2003</b>	2,380,171	\$ 11,900,855	\$ 8,375,708	\$ 27,286	\$ (192,292)	\$ 20,111,557
Net income for three months ended March 31, 2004	-	-	-	134,641	-	134,641
Unrealized loss on available, for sale securities, net of income taxes	-	-	-	-	184,184	<u>184,184</u>
<b>Total comprehensive income</b>						<u>318,825</u>
<b>Balance-March 31, 2004</b>	<u>2,380,171</u>	<u>\$ 11,900,855</u>	<u>\$ 8,375,708</u>	<u>\$ 161,927</u>	<u>\$ (8,108)</u>	<u>\$ 20,430,382</u>
<b>Balance - December 31, 2004</b>	2,400,139	\$ 12,000,695	\$ 8,478,868	\$ 784,340	\$ (147,565)	\$ 21,116,338
Net income for three months ended March 31, 2005	-	-	-	371,853	-	371,853
Unrealized loss on available, for sale securities, net of income taxes	-	-	-	-	(124,965)	<u>(124,965)</u>
<b>Total comprehensive income</b>						<u>246,888</u>
Stock options exercised	6,240	31,200	33,800			65,000
<b>Balance-March 31, 2005</b>	<u>2,406,379</u>	<u>\$ 12,031,895</u>	<u>\$ 8,512,668</u>	<u>\$ 1,156,193</u>	<u>\$ (272,530)</u>	<u>\$ 21,428,226</u>

The accompanying notes are an integral part of these consolidated financial statements.

Item 1. Financial Statements (Continued)

**Consolidated Statements of Cash Flows**  
**Monarch Bank and Subsidiaries**

Unaudited

	<b>3 Months Ended March 31,</b>	
	<b>2005</b>	<b>2004</b>
<b>Operating activities:</b>		
Net income	\$ 371,853	\$ 134,641
Adjustments to reconcile to net cash provided by operating activities:		
Provision for loan losses	173,000	27,000
Provision for depreciation	104,513	100,981
Accretion of discounts and amortization of premiums, net	36,130	44,983
Deferral of loan costs, net of deferred fees	(27,622)	1,546
Net (gain) loss on disposition of investment securities	10,841	16,454
Changes in:		
Mortgage loans held for sale	1,086,036	(886,806)
Interest receivable	(132,923)	26,447
Other assets	(419,223)	98,392
Other liabilities	119,863	92,465
Net cash from operating activities	1,322,468	(343,897)
<b>Investing activities:</b>		
Purchases of available-for-sale securities	(9,995,567)	(18,563,327)
Purchases of held-to-maturity securities	(600,000)	-
Sales, maturities, calls and paydowns of available-for-sale securities	16,158,600	21,564,709
Loan originations, net of principal repayments	(16,810,639)	(8,913,180)
Purchases of premises, furniture and equipment	(169,294)	(148,787)
Purchase of restricted equity securities	(939,500)	(1,100)
Redemption of restricted equity securities	1,304,100	-
Net cash used by investing activities	(11,052,300)	(6,061,685)
<b>Financing activities:</b>		
Net increase in noninterest bearing deposits	15,275,331	5,739,843
Net increase in interest bearing deposits	6,447,376	2,824,173
Net increase (decrease) in securities sold under repurchase agreements	-	(226,022)
Net decrease in federal funds purchased	(1,860,000)	-
Net decrease in FHLB advances	(10,000,000)	-
Net decrease in other short-term borrowings	-	10,000
Proceeds from issuance of common stock	65,000	-
Net cash from financing activities	9,927,707	8,347,994
<b>INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>197,875</b>	<b>1,942,412</b>
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD</b>	<b>5,228,798</b>	<b>6,113,441</b>
<b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>	<b>\$ 5,426,673</b>	<b>\$ 8,055,853</b>
<b>SUPPLEMENTAL SCHEDULES AND CASH FLOW INFORMATION</b>		
Cash paid for:		
Interest on deposits and other borrowings	\$ 1,012,018	\$ 761,020
Income taxes	\$ 520,000	\$ 35,000

The accompanying notes are an integral part of these consolidated financial statements.

**MONARCH BANK**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 - BASIS OF PRESENTATION**

In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments consisting of normal recurring accruals necessary to present fairly Monarch Bank's financial position as of March 31, 2005; the consolidated statements of income for the three months ended March 31, 2005 and 2004; the consolidated statements of changes in shareholders' equity for the three months ended March 31, 2005 and 2004; and the consolidated statements of cash flows for the three months ended March 31, 2005 and 2004. These financial statements have been prepared in accordance with the instructions to Form 10-QSB and, therefore, do not include all of the disclosures and notes required by generally accepted accounting principles. The financial statements include the accounts of Monarch Bank and its subsidiaries, and all significant intercompany accounts and transactions have been eliminated. Operating results for the three month period ended March 31, 2005 are not necessarily indicative of the results that may be expected for the year ended December 31, 2005.

**NOTE 2 - GENERAL**

Monarch Bank ("Monarch" or the "Bank") is a Virginia chartered bank that offers a full range of banking services, primarily to individuals and businesses in the Hampton Roads area of Virginia. Incorporated in Virginia on May 1, 1998, Monarch commenced operations as a commercial bank on April 14, 1999 at its main office in the Greenbrier section of Chesapeake. In addition to its main office, Monarch Bank has five other offices – in the Great Bridge section of Chesapeake, the Lynnhaven section of Virginia Beach, the Oceanfront section of Virginia Beach, the Ghent section of Norfolk, and the Downtown section of Norfolk.

In September 2000, Monarch formed a subsidiary mortgage company, Monarch Home Funding, LLC, ("MHF") to provide permanent residential mortgage loans. MHF began operations as a mortgage broker in September 2000, originating conventional, FHA and VA residential loans. On April 1, 2003, the Bank increased its ownership interest from 51% to 90% in Monarch Home Funding, LLC by purchasing interests from its partners. In the third quarter of 2003, MHF became a mortgage lender. As a mortgage lender, MHF can underwrite mortgage loans for its customers, providing additional mortgage related products and services with much more efficiency. MHF originates conventional, FHA and VA residential loans and offers a construction-permanent loan program. On April 1, 2004, Monarch purchased the remaining interest in Monarch Home Funding, LLC from its partners, to increase its ownership to 100%. MHF has one office in Chesapeake.

In August 2001, the Bank formed Monarch Investments, LLC for the purpose of selling annuities and investment securities and services. The Bank owns a 100% interest in Monarch Investments, LLC. The Bank has invested approximately \$225,000 in Bankers Investment Group, LLC, the parent company of BI Investments, LLC. Bankers Investments Group, LLC is the parent company of BI Investments, LLC, a registered brokerage firm and investment advisor. BI Investments, LLC sells non-deposit investment products in various community banks in Virginia, which are partners in Bankers Investments Group, LLC with the Virginia Bankers Association Management Services Division.

In January 2003, the Bank invested approximately \$452,000 for a partial ownership interest in Bankers Insurance, LLC. Owned by 56 community banks, Bankers Insurance is a full service property/casualty and life/health agency that ranks as one of the largest agencies in Virginia. Bankers Insurance provides insurance to Monarch Bank customers and to the general public.

In February 2004, the Bank formed Monarch Capital LLC for the purpose of engaging in the commercial real estate brokerage business. The Bank owns a 100% interest in Monarch Capital LLC.

In November 2004, the Bank invested \$87,000 for a partial ownership interest in Bankers Title of Hampton Roads, LLC. Owned by 11 community banks, Bankers Title is a full service title insurance agency. Bankers Title provides title insurance products and services to Monarch Bank customers and to the general public.

### NOTE 3 - EARNINGS PER SHARE (“EPS”)

Basic earnings per share (EPS) excludes dilution, and is computed by dividing income available to common shareholders by the weighted-average number of shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised, converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity. The following is a reconciliation of the numerators and denominators of the basic and diluted earnings per share computations.

	<u>3 months ended March 31,</u>	
	<u>2005</u>	<u>2004</u>
Net income (numerator, basic and diluted)	\$ 371,853	\$ 134,641
Weighted average shares outstanding (denominator)*	<u>2,401,398</u>	<u>2,380,171</u>
Income per common share - basic	<u>\$ 0.15</u>	<u>\$ 0.06</u>
Weighted average shares - diluted (denominator)	<u>2,502,398</u>	<u>2,482,243</u>
Income per common share - diluted	<u>\$ 0.15</u>	<u>\$ 0.05</u>

The dilutive effect of stock options is 101,373 and 102,072 shares the quarter ending March 31, 2005 and 2004, respectively.

### NOTE 4 – COMPREHENSIVE INCOME

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income. The only component of other comprehensive income consists of unrealized gains and losses on available-for-sale securities. The Bank accounts for comprehensive income in accordance with FASB Statement No. 130, Reporting Comprehensive Income. The following is a detail of comprehensive income for the three months ended March 31, 2005 and 2004:

	<u>Three Months Ended</u> <u>March 31,</u>	
	<u>2005</u>	<u>2004</u>
Net Income	\$371,853	\$134,641
Change in unrealized gains (losses) on securities available for sale, net of tax expense	<u>(124,965)</u>	<u>184,184</u>
Total comprehensive income	<u>\$246,888</u>	<u>\$318,825</u>
Unrealized holding (losses) gains during the period	\$ (178,294)	\$ 230,353
Less reclassification adjustment for losses(gains) included in income	<u>10,841</u>	<u>16,454</u>
Total other comprehensive (loss) income before income tax expense	(167,453)	246,807
Income tax benefit (expense)	<u>42,488</u>	<u>(62,623)</u>
Net unrealized (losses) gains	<u>\$ (124,965)</u>	<u>\$184,184</u>

## NOTE 5 - STOCK BASED COMPENSATION

As of March 31, 2005, the Corporation had a stock-based compensation plan. The Corporation accounts for the plan under the recognition and measurement principles of APB Opinion 25, *Accounting for Stock Issued to Employees*, and related interpretations. No stock-based employee compensation cost is reflected in net income, as all options granted under the plan had an exercise price equal to the market value of the underlying common stock on the date of the grant. The following illustrates the effect on net income and earnings per share for the three month periods ended March 31, 2005, and 2004 had the fair value recognition provisions of FASB Statement No. 123, *Accounting for Stock-Based Compensation*, been adopted.

	Three Months Ended	
	March 31	
	<u>2005</u>	<u>2004</u>
Net income, as reported	\$371,853	\$134,641
Deduct: total stock-based employee compensation expense based on fair value method of awards	<u>(3,976)</u>	<u>(15,648)</u>
Pro forma net income	<u>\$367,877</u>	<u>\$118,993</u>
Basic earnings per share:		
As reported	\$0.15	\$0.06
Pro forma	\$0.15	\$0.05
Diluted earning per share:		
As reported	\$0.15	\$0.05
Pro Forma	\$0.15	\$0.05

## CRITICAL ACCOUNTING POLICIES

The Bank's critical accounting policies are listed below. A summary of the Bank's significant accounting policies is set forth in Note 1 to the Consolidated Financial Statements in the Bank's 2004 Annual Report on Form 10-K.

The Bank's financial statements are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The financial information contained within our statements is, to a significant extent, financial information that is based on measures of the financial effects of transactions and events that have already occurred. A variety of factors could affect the ultimate value that is obtained when earning income, recognizing an expense, recovering an asset or relieving a liability. In addition, GAAP itself may change from one previously acceptable method to another method. Although the economics of our transactions would be the same, the timing of events that would impact our transactions could change.

The financial statements and related data presented herein were prepared in accordance with generally accepted accounting principles, which require the measurement of financial position and operating results in terms of historical dollars, without considering the changes in relative purchasing power of money over time due to inflation. The effect of changing prices on financial institutions is typically different from other industries as the Bank's assets and liabilities are monetary in nature. Interest rates are significantly impacted by inflation, but neither the timing nor the magnitude of the changes are directly related to price level indices.

On March 9, 2004, the SEC Staff issued Staff Accounting Bulletin No. 105, *"Application of Accounting Principles to Loan Commitments"* ("SAB 105"). SAB 105 clarifies existing accounting practices relating to the valuation of issued loan commitments, including interest rate lock commitments ("IRLC"), subject to SFAS No. 149 and Derivative Implementation Group Issue C13, *"Scope Exceptions: When a Loan Commitment is included in the Scope of Statement 133."* Furthermore, SAB 105 disallows the inclusion of the values of a servicing component and other internally developed intangible assets in the initial and subsequent IRLC valuation. The provisions of SAB 105 were effective for loan commitments entered into after March 31, 2004. The Company has adopted the provisions of SAB 105. Since the provisions of SAB 105 affect only the timing of the recognition of mortgage banking income, management does not anticipate that this guidance will have a material adverse effect on either the Company's consolidated financial position or consolidated results of operations.

Emerging Issues Task Force Issue No. (EITF) 03-1 "*The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*" was issued and is effective March 31, 2004. The EITF 03-1 provides guidance for determining the meaning of "other than-temporarily impaired" and its application to certain debt and equity securities within the scope of Statement of Financial Accounting Standards No. 115 "*Accounting for Certain Investments in Debt and Equity Securities*" ("SFAS No. 115") and investments accounted for under the cost method. The guidance requires that investments which have declined in value due to credit concerns or solely due to changes in interest rates must be recorded as other-than-temporarily impaired unless the Company can assert and demonstrate its intention to hold the security for a period of time sufficient to allow for a recovery of fair value up to or beyond the cost of the investment which might mean maturity. This issue also requires disclosures assessing the ability and intent to hold investments in instances in which an investor determines that an investment with a fair value less than cost is not other-than-temporarily impaired.

On September 30, 2004, the Financial Accounting Standards Board decided to delay the effective date for the measurement and recognition guidance contained in Issue 03-1. This delay does not suspend the requirement to recognize other-than-temporary impairments as required by existing authoritative literature. The disclosure guidance in Issue 03-1 was not delayed. Management continues to study this new issue but does not anticipate that this guidance will have a material adverse effect on either the Company's consolidated financial position or consolidated results of operations.

EITF No. 03-16, "*Accounting for Investments in Limited Liability Companies*" was ratified by the Board and is effective for reporting periods beginning after June 15, 2004. APB Opinion No. 18, "*The Equity Method of Accounting Investments in Common Stock*," prescribes the accounting for investments in common stock of corporations that are not consolidated. AICPA Accounting Interpretation 2, "*Investments in Partnerships Ventures*," of Opinion 18, indicates that "many of the provisions of the Opinion would be appropriate in accounting" for partnerships. In *EITF Abstracts*, Topic No. D-46, "*Accounting for Limited Partnership Investments*," the SEC staff clarified its view that investments of more than 3 to 5 percent are considered to be more than minor and, therefore, should be accounted for using the equity method. Limited liability companies (LLCs) have characteristics of both corporations and partnerships, but are dissimilar from both in certain respects. Due to those similarities and differences, diversity in practice exists with respect to accounting for non-controlling investments in LLCs. The consensus reached was that an LLC should be viewed as similar to a corporation or similar to a partnership for purposes of determining whether a non-controlling investment should be accounted for using the cost method or the equity method of accounting.

On July 30, 2002, Congress enacted the Sarbanes-Oxley Act of 2002 (the Act). Among other provisions, the Act provides for the establishment of the Public Company Oversight Board, rules with respect to auditor independence, corporate governance and responsibility, and enhanced financial disclosures. One of the more significant provisions of Section 404 of Sarbanes-Oxley involves internal control attestation by independent auditors. This provision was to first apply to the Company as of December 31, 2005. However, on March 2, 2005, the Securities and Exchange Commission extended the dates for non-accelerated filers to comply with Section 404 of the Act. As the Company is a non-accelerated filer, its compliance date is extended to December 31, 2006.

## ITEM 2.

### **MONARCH BANK MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The purpose of this discussion is to focus on important factors affecting the Bank's financial condition and results of operations. The discussion and analysis should be read in conjunction with the Consolidated Financial Statements, and supplemental financial data.

This report contains forward-looking statements with respect to the financial condition, results of operations and business of the Bank. These forward-looking statements involve risks and uncertainties and are based on the beliefs and assumptions of management of the Bank and on information available at the time these statements and disclosures were prepared. Factors that may cause actual results to differ materially from those expected include the following:

- General economic conditions may deteriorate and negatively impact the ability of borrowers to repay loans and depositors to maintain balances.
- Changes in interest rates could reduce income
- Competitive pressures among financial institutions may increase.
- The businesses that the Bank is engaged in may be adversely affected by legislative or regulatory changes, including changes in accounting standards.
- New products developed or new methods of delivering products could result in a reduction in business and income for the Bank.
- Adverse changes may occur in the securities market.

#### **Earnings Summary**

Monarch Bank reported net income of \$371,853 for the three-month period ending March 31, 2005, compared to \$134,641 for the same period in 2004, an increase of \$237,212, or 176.2%. Net interest income, the Bank's primary source of earnings, increased \$718,902, or 53.2%, for the first three months of 2005, compared to 2004. Non-interest income increased \$79,697 or 14.5% and non-interest expenses increased \$301,551, or 18.1%. Basic and diluted earnings per share of common stock were both \$0.15 for the first three months of 2005, compared to \$.06 for basic and \$.05 for diluted earnings per share for 2004. The first quarter of 2005 was Monarch Bank's nineteenth consecutive profitable quarter.

Profitability as measured by Monarch's annualized return on average assets (ROA) was 0.68% for the three months ended March 31, 2005, compared to 0.30% for the same period in 2004. The annualized return on average equity (ROE) was 6.86% for the first three months of 2005 compared to 2.68% for 2004.

#### **Net Interest Income**

Net interest income represents a principal source of earnings for the Bank. Increases in net interest income are primarily attributable to the overall growth of the Bank, arising from higher average outstanding balances in 2005 than 2004, and the increase in the net interest margin. The Federal Reserve Bank's Open Market Committee began increasing short-term interest rates in late June of 2004, and increased rates twice during the first quarter of 2005. These increases raised the Federal Funds rate from 2.25% at the beginning of the quarter to 2.75% at the end of the quarter. In 2004 this rate was 1.00% for the entire period of that year. The increase in the Federal Funds target rate raised the Wall Street Journal Prime Rate from 5.25% to 5.75% during 2005. A majority of the Bank's loans use the Wall Street Journal Prime Rate as their rate index, and increases in this rate increase interest income.

Net interest income for the first three months of 2005 was \$2,071,357, up from \$1,352,455 for the same period in 2004, increasing by \$718,902 or 53.2%. For the three months ended March 31, 2005, compared to the three months ended March 31, 2004, total interest and fees on loans increased by \$1,006,138, or 52.7%. Interest on investment securities decreased \$35,302, or 19.7%. With rate increases in 2004 and early 2005, a management decision was made to reduce the fixed rate securities portfolio in favor of variable rate loans due to the higher yields and faster repricing available on loans. Interest on federal funds sold decreased \$8,652 or 61.1% due to lower volume, and dividends on restricted equity securities increased \$2,087 or 15.6% for the first three months of 2005 compared to 2004 due to higher balances in stock in the Federal Home Loan Bank of Atlanta and increases in yields on these investments.

## Average Balances, Income and Expenses, Yields and Rates

The following table sets forth average balances of total interest earning assets and total interest bearing liabilities for the periods indicated, showing the average distribution of assets, liabilities, stockholders' equity and the related income, expense and corresponding weighted average yields and costs.

### AVERAGE BALANCES, INCOME AND EXPENSE, YIELDS AND RATES

	For Three Month Period Ended March 31,					
	2005			2004		
	Average Balance	Income/ Expense	Yield Rate(1)	Average Balance	Income/ Expense	Yield Rate(1)
<b>ASSETS</b>						
Securities, at amortized cost						
Taxable	\$ 18,011,544	\$ 142,197	3.20%	\$ 22,262,218	\$ 163,742	2.96%
Tax-exempt (2)	418,927	2,674	2.59%	2,601,445	23,518	3.64%
Total securities	18,430,471	144,871	3.19%	24,863,663	187,260	3.03%
Loans, net	190,582,788	2,915,642	6.20%	139,156,440	1,909,504	5.52%
Federal funds sold	803,760	5,511	2.78%	6,178,834	14,163	0.92%
Dividend-earning restricted equity securities	1,742,514	15,475	3.60%	1,115,614	13,388	4.83%
Interest-bearing deposits at other banks	382,164	1,752	1.86%	592,815	1,343	0.91%
Total earning assets	211,941,697	3,083,251	5.90%	171,907,366	2,125,658	4.97%
Less: Allowance for loan losses	(1,871,122)			(1,521,692)		
Total nonearning assets	10,503,790			8,863,427		
Total assets	<u>\$ 220,574,365</u>			<u>\$ 179,249,101</u>		
<b>LIABILITIES and STOCKHOLDERS' EQUITY</b>						
Interest-bearing deposits:						
Checking	\$ 9,760,206	\$ 5,857	0.24%	\$ 8,737,216	\$ 9,215	0.42%
Regular savings	15,657,322	26,445	0.68%	18,289,562	30,850	0.68%
Money market savings	43,764,116	243,145	2.25%	6,270,381	9,905	0.64%
Certificates of deposit						
Under \$100,000	43,225,262	343,389	3.22%	38,982,807	267,408	2.76%
\$100,000 and over	34,514,653	263,841	3.10%	48,854,155	390,490	3.21%
Total interest-bearing deposits	146,921,559	882,677	2.44%	121,134,121	707,868	2.35%
Borrowings	18,368,421	128,307	2.83%	12,263,565	57,339	1.88%
Total interest-bearing liabilities	165,289,980	\$ 1,010,983	2.48%	133,397,686	\$ 765,207	2.31%
Noninterest-bearing liabilities						
Demand deposits	32,855,056			25,436,235		
Other noninterest-bearing liabilities	430,834			183,849		
Total liabilities	198,575,870			159,017,770		
Shareholders' equity	21,998,495			20,231,331		
Total liabilities and stockholders' equity	<u>\$ 220,574,365</u>			<u>\$ 179,249,101</u>		
Net interest income (2)		<u>\$ 2,072,267</u>			<u>\$ 1,360,451</u>	
Interest rate spread (2)(3)			<u>3.42%</u>			<u>2.67%</u>
Net interest margin (2)(4)			<u>3.97%</u>			<u>3.18%</u>

(1) Yields are annualized and based on average daily balances.

(2) Income and yields are reported on a taxable equivalent basis assuming a federal tax rate of 34%, with a \$909 adjustment for 2005 and a \$7,996 adjustment for 2004

(3) Represents the differences between the yield on total average earning assets and the cost of total interest-bearing liabilities.

(4) Represents the ratio of net interest-earnings to the average balance of interest-earning assets.

The net interest spread on a tax-equivalent basis improved for the first three months of 2005 to 3.42%, compared to 2.67% for the same period in 2004. The yield on earning assets increased 93 basis points to 5.90%, while the rate on interest-bearing liabilities increased only 17 basis points to 2.48%. This resulted in the improved interest rate spread and net interest margin. The net interest margin was at its highest level since 2001.

Interest expense on deposits increased \$174,810, or 24.7% and interest expense on borrowings increased \$70,968 or 123.8%. The increase in deposit expense is due to the increase in average deposits, arising from the overall growth of the Bank, and an increase in the overall rates paid on deposits. The increase in borrowing interest expense is the result of a higher rate environment and the bank's strategy to replace higher cost out-of-market certificates of deposits with FHLB borrowings.

See the Average Balances, Income and Expenses, Yields and Rates exhibit for more details on net interest income.

### **Noninterest Income**

During the three month period ending March 31, 2005, total noninterest income, including security gains and losses, increased by \$79,697, or 14.5% when compared to the same period in 2004.

The largest component of noninterest income is mortgage banking income from the Bank's mortgage subsidiary, Monarch Home Funding, LLC. For the first quarter of 2005 gross mortgage banking income grew \$38,532, or 9.4% from the same period in 2004. This income growth was achieved despite increases in mortgage interest rates during 2005 and a more competitive environment that required more competitive pricing. The new and existing home sale market continues to perform well in the Bank's primary trade area.

Service charges and fees on deposit accounts increased \$23,292 for the three months ending March 31, 2005, or 15.6% from the same period in 2004. The increase was driven by two primary components. The first was the introduction of an overdraft protection product for consumer checking accounts that produced an increase in overdraft fee income. The other component was increased account service charge income due to deposit account growth. ATM fees also continue to contribute to noninterest income. The Bank has an agreement with a third-party vendor to brand ATMs in Food Lion grocery stores in southeastern Virginia and northeastern North Carolina. This relationship now includes 35 active ATMs. In return for supplying the cash for the machines and paying the machines' cash servicing fees, the Bank receives a portion of the transaction surcharge and the Bank's customers can withdraw cash from the machines without a fee or transaction surcharge. A portion of the ATM fee increase was also due to fees generated at the Bank's 6 ATMs located at the banking center sites.

Net losses on the sales of investment securities amounted to \$10,841 for the first three months of 2005, compared to losses of \$16,454 for the same period in 2004. Management took losses in certain security positions to improve future investment portfolio yield.

### **Noninterest Expense**

During the three month period ending March 31, 2005, total noninterest expenses were \$1,963,612, an increase of \$301,551, or 18.1% over the same period last year. This increase is attributable to following factors: 1) an increase in salaries and employee benefits of \$248,456, primarily arising from additional salaries due to the two new Norfolk banking offices, the addition of new production and support staff, and higher employee benefits costs; 2) an increase of \$41,674 in occupancy and furniture and equipment expenses from the opening of two new banking offices in the Norfolk market; and 3) an increase of \$90,974 in other expenses related to the Bank's growth. Savings were observed in data processing services and in professional fees due to the Bank hiring an internal technology position to replace higher cost outsourced services. Virginia Bank franchise taxes also increased due to a higher capital level in 2005.

### **Income Taxes**

The income tax provision for the first three months of 2005 was \$190,650, an increase of \$121,289 from \$69,361 reported a year earlier. The effective tax rate for the first three month period of 2005 was 33.9%, compared to 34.0% for the same period of 2004.

## **FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES**

## General

Total assets increased 4.5% to \$237,151,960 at March 31, 2005 when compared to assets of \$226,857,502 at December 31, 2004. On an annual basis total assets increased 22.9% at March 31, 2005 when compared to assets of \$192,889,933, at March 31, 2004. Total loans as of March 31, 2005 were \$195.8 million, an increase of \$16.8 million, or 9.4%, from \$178.9 million at year-end 2004. On an annual basis total loans increased 36.9% at March 31, 2005 when compared to total loans of \$143,041,203, at March 31, 2004. Mortgages held for sale declined slightly. Investment securities decreased \$5.7 million, or 17.3% to \$27.3 million at March 31, 2005, compared to \$33.0 million as of December 31, 2004. Cash and cash equivalents increased slightly from December 31, 2004 to March 31, 2005.

Deposits increased \$21.7 million, or 12.7%, during the three months ended March 31, 2005. The majority of the growth was in noninterest-bearing demand deposit accounts, which increased by approximately \$15.3 million during the period. This increase is primarily due the increased marketing efforts of the bank to attract both consumer and commercial noninterest-bearing checking accounts. The growth in the interest-bearing deposit category is attributed to money market deposit account marketing and pricing. Other factors of the increases in total deposits are the overall growth of the Bank and the opening of the two new Norfolk offices since March 31<sup>st</sup> of 2004.

Stockholders' equity was \$21,428,226 at March 31, 2005, compared to \$21,116,338 at December 31, 2004. Components of the change in stockholders' equity include net income of \$371,853 offset partially by an increase in net unrealized losses on available-for-sale securities totaling \$124,965 due to an increase in market interest rates.

## Asset Quality

The Bank had no non-performing loans past due for more than 90 days and no other non-performing assets as of March 31, 2005, and no non-performing loans or assets at December 31, 2004. Non-performing assets are defined as nonaccrual loans, loans past due 90 days or more and still accruing interest, restructured loans and other real estate owned. There were also no impaired loans or other real estate owned at March 31, 2005 or December 31, 2004. The Bank continues to demand a high level of credit quality on new loans.

## Allowance for Loan Losses

The allowance for loan losses is to provide for losses inherent in the loan portfolio. The Bank's Loan Committee has responsibility for determining the level of the allowance for loan losses, subject to the review of the Board of Directors. Among other factors, the Committee on a quarterly basis considers the Bank's historical loss experience, the size and composition of the loan portfolio, the value and adequacy of collateral and guarantors, non-performing credits, the Bank's loan "Watch" list, and national and local economic conditions.

While the Bank believes it has sufficient allowance for its existing portfolio, there can be no assurances that an additional allowance for losses on existing loans may not be necessary in the future. The allowance for loan losses totaled \$1,997,000 and \$1,804,000 at March 31, 2005 and December 31, 2004, respectively. The ratio of the allowance for loan losses to total loans outstanding at March 31, 2005 and on December 31, 2004 was 1.01%.

During the first three months of 2005 the Bank had \$173,000 in loan loss allowance provision expense. There were no loans charged off, which are charged directly to the allowance when they occur, during the first three-month periods of 2005 and 2004. Since it began business in 1999, the Bank has had only two small consumer loan charge-offs totaling less than \$2,000. Recoveries during the first quarters of 2005 and 2004 amounted to \$0. The table below summarizes the activity in the allowance for loan losses for the three-month period ending March 31, 2005 and 2004.

Activity in the allowance for loan losses for the three months ended March 31 was as follows:

	<b>2005</b>	<b>2004</b>
Balance, January 1	\$ 1,804,000	\$ 1,500,000
Provisions charged against income	173,000	27,000
Recoveries of loans charged off	0	0
Loans charged off	<u>0</u>	<u>0</u>
Balance at end of period	<u>\$ 1,977,000</u>	<u>\$ 1,527,000</u>

The Bank has developed a methodology to determine an allowance to absorb probable loan losses inherent in the portfolio based on evaluations of the collectibility of loans, historical loss experience, peer bank loss experience, delinquency trends, economic conditions, portfolio composition, and specific loss estimates for loans considered substandard or doubtful. All commercial and commercial real estate loans that exhibit probable or observed credit weaknesses are subject to individual review. If necessary, reserves would be allocated to individual loans based on management's estimate of the borrower's ability to repay the loan given the availability of collateral and other sources of cash flow. Any reserves for impaired loans are measured based on the present rate or fair value of the underlying collateral. The Bank evaluates the collectibility of both principal and interest when assessing the need for a loss accrual. A composite allowance factor that considers the Bank's and other peer bank loss experience ratios, delinquency trends, economic conditions, and portfolio composition are applied to the total of commercial and commercial real estate loans not specifically evaluated.

Homogenous loans, such as consumer installment, residential mortgage loans, home equity loans, and smaller consumer loans are not individually reviewed and are generally risk graded at the same levels. The risk grade and reserves are established for each homogenous pool of loans and are based on the expected net charge-offs from a current trend in delinquencies, losses or historical experience and general economic conditions. The Bank has no material delinquencies in these types of loans, and has not, since inception, had a trend or an indication of a trend that would guide the Bank in expected material losses in these types of homogenous pools of loans. Management believes that the allowance for loan losses is adequate to absorb any inherent losses on existing loans in the Bank's loan portfolio at March 31, 2005.

### **Liquidity**

Management monitors and plans the Bank's liquidity position for future periods. Liquidity is provided from cash and due from banks, interest-bearing deposits in other banks, repayments from loans, increases in deposits, lines of credit from four correspondent banks and two federal agency banks and a planned structured continuous maturity of investments. Management believes that these factors provide sufficient and timely liquidity for the foreseeable future.

Management also takes into account any liquidity needs generated by off-balance sheet transactions such as commitments to extend credit, commitments to purchase securities and standby letters of credit.

The Bank has a line of credit equal to 30% of assets with the Federal Home Loan Bank of Atlanta (FHLB) that equaled approximately \$71,145,000 with \$51,145,000 available at March 31, 2005. Should the Bank ever desire to increase their line of credit beyond the current 30% limit, the FHLB would allow borrowings of up to 40% of total assets once the bank meets specific eligibility and collateral requirements. Borrowings outstanding under the FHLB line of credit were \$20,000,000 at March 31, 2005 and \$30,000,000 at December 31, 2004. The Bank has three borrowing advances outstanding as of March 31, 2005, with the following final maturities:

<u>Advance Amount</u>	<u>Expiration Date</u>
\$ 10,000,000	April 2005
5,000,000	March 2012
<u>5,000,000</u>	February 2013
<u>\$20,000,000</u>	

The advance maturing in 2013 is a convertible advance that matures in February 2013 but has a one-time call provision in February 2008. At that date, the FHLB can call the borrowing; if it does, the Bank has the option of repaying the advance or refinancing at the then current rate. The interest rate is currently 2.97%.

The advance maturing in 2012 has a one time repayment option in 2007, whereby the Bank can repay the borrowing. If not paid at that time the borrowing converts to a fixed-term five year borrowing at the then current rates. This borrowing floats at a rate set below 90 day Libor rates until the reset date. The interest rate is currently 2.47%.

In the course of operations, due to fluctuations in loan and deposit levels, the Bank occasionally finds it necessary to purchase or sell federal funds on a short-term basis. The Bank also has federal funds lines of credit facilities established with four other banks in the total amount of \$17,000,000 available with \$1,952,000 in federal funds purchased at March 31, 2005. The Bank also has access to the Federal Reserve Bank's discount window should a liquidity crisis occur.

The Bank has no material commitments or long-term debt for capital expenditures at the report date. The only long-term debt is for funding loans and is described below under Borrowings.

The Bank uses borrowings at the end of each quarter to increase its investment securities that are not subject to taxation by the Commonwealth of Virginia. The Bank is not subject to state income tax but is subject to Virginia Franchise Tax, which is calculated on its capital level, less certain deductions. One deduction is the average balances of bonds that are not subject to taxation by the Commonwealth of Virginia, primarily certain qualified U.S. Government Agency bonds. The Bank has found that it can save more in taxes than it pays in interest expense. Right before the end of each calendar quarter, the Bank purchases FHLB discount notes that mature soon after the quarter-end. The proceeds from the maturity of the discount note are used to repay the borrowings. The Bank only enters into this type of agreement near the end of the quarter since that is the period used in the franchise tax calculation.

#### **Off-Balance Sheet Arrangements**

The Bank enters into certain financial transactions in the ordinary course of performing traditional banking services that result in off-balance sheet transactions. The off-balance sheet transactions recognized as of March 31, 2005 and December 31, 2004 were commitments to extend credit and standby letters of credit only.

Commitments to extend credit, which amounted to \$64,900,000 at March 31, 2005 and \$81,746,000 at December 31, 2004, represent legally binding agreements to lend to customers with fixed expiration dates or other termination clauses. Since many of the commitments are expected to expire without being funded, the total commitment amounts do not necessarily represent future liquidity requirements.

As of March 31, 2005 and December 31, 2004, there were no commitments to purchase securities.

Standby letters of credit are conditional commitments issued by the Bank guaranteeing the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. At March 31, 2005 and December 31, 2004, the Bank had \$1,079,000 and \$1,058,000 respectively, in outstanding standby letters of credit.

The Bank and its subsidiary, Monarch Home Funding, LLC, have five non-cancelable leases for premises. The original lease terms are from fourteen months to thirty years and have various renewal and option dates.

## Capital Adequacy

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Management reviews the adequacy of the Bank's capital on an ongoing basis with reference to the size, composition, and quality of the Bank's resources and compliance with regulatory requirements and industry standards. Management seeks to maintain a capital structure that will assure an adequate level of capital to support anticipated asset growth and absorb potential losses.

Federal regulatory risk-based capital ratio guidelines require percentages to be applied to various assets including off-balance sheet assets in relation to their perceived risk. Tier 1 capital consists of stockholders' equity and minority interests in consolidated subsidiaries, less net unrealized gains on available-for-sale securities. Tier 2 capital, a component of total capital, consists of a portion of the allowance for loan losses, certain components of nonpermanent preferred stock and subordinated debt. Monarch's ratios exceed regulatory requirements. As of March 31, 2005 the Bank had a Tier 1 risk-based capital ratio of 9.18% and a Total risk-based capital ratio of 10.02%. At December 31, 2004 these ratios were 9.92% and 10.76%, respectively.

On April 11, 2005, the Bank announced a public offering of a minimum of 250,000 shares and a maximum of 450,000 shares of common stock at a pre-established price of \$14.50 per share. The offering is set to run until May 31, 2005, or can close earlier if all 450,000 shares are sold prior to that date. This capital will be used for general corporate purposes to support the continued growth of the Bank, and management feels assured the minimum offering amount will be surpassed. On May 6, 2004, the Board of Directors approved a 6-for-5 stock split to stockholders of record on May 17, 2004. The number of shares issued and outstanding, both prior to and subsequent to the stock split, were approximately 1,987,676 and 2,385,211, respectively. The Bank's stock par value was affected by the stock split; additional paid in capital was adjusted so that the stock par value remains at \$5.00 per share. All share and per share amounts are retroactively adjusted to reflect the stock split.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The effective management of market risk is essential to achieving the Bank's objectives. Market risk reflects the risk of economic loss resulting from adverse changes in market prices and interest rates. This risk of loss can be reflected in diminished current market values and/or reduced potential net interest income in future periods. The Corporation is not subject to currency exchange risk or commodity price risk.

As a financial institution, interest rate risk and its impact on net interest income is the primary market risk exposure. The Asset/Liability Management Committee ("ALCO") is primarily responsible for establishing asset and liability strategies and for monitoring and controlling liquidity and interest rate risk. The Bank evaluates interest sensitivity risk in accordance with its asset liability policies, and then formulates strategies regarding asset originations, pricing, funding sources, and off-balance sheet commitments in order to decrease sensitivity risk. These strategies are based on management's outlook regarding future interest rate movements, the state of the regional and national economy, and other financial and business risk factors. The Bank establishes prices for deposits and loans based primarily on local market conditions.

The interest sensitivity position ("gap") is the difference between interest sensitive assets and interest sensitive liabilities in a specific time interval. The gap can be managed by repricing assets or liabilities, affected by selling securities available for sale, by replacing an asset or liability at maturity, or by adjusting the interest rate or the life of an asset or liability. Matching of assets and liabilities repricing in the same interval helps to hedge the risk and minimize the impact on interest income in periods of rising and falling interest rates.

Generally, positive gaps affect net interest margins and earnings negatively in periods of falling rates, and conversely, higher negative gaps adversely impact net interest margin and earnings in periods of rising rates as a higher volume of liabilities will reprice quicker than assets over the period for which the gap is computed.

Impacts of changing interest rates on loans and deposits are reflected in the Bank's financial statements. Management believes that the mortgage banking operations of its subsidiary, Monarch Home Funding, LLC, provide somewhat of a natural interest rate hedge, in that the Bank is interest rate sensitive in the three-month period. When loan interest rates decline, the Company's earnings will be negatively impacted in the three-month period but the mortgage company's volume should increase as the demand for refinancing increases. The reverse should occur in rising interest rate.

Monarch is asset-sensitive, primarily due to its adjustable rate loan portfolio. The majority of these loans are indexed to the Wall Street Journal Prime rate and can adjust either daily or monthly. This asset-sensitive position positively impacts the Bank in a rising rate environment, as asset-yields rise faster than the cost of funding those assets.

### **ITEM 4. CONTROLS AND PROCEDURES**

We maintain a system of internal controls and procedures designed to provide reasonable assurance as to the reliability of our published financial statements and other disclosures included in this report. Within the 90 days prior to the date of this report, the Corporation carried out an evaluation, under the supervision and with the participation of the Bank's management, including the Bank's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-14. Based upon that evaluation, the Bank's Chief Executive Officer and Chief Financial Officer concluded that the Bank's disclosure controls and procedures are effective in timely alerting them to material information relating to the Corporation (including its consolidated subsidiaries) required to be included in periodic SEC filings. There have been no significant changes in the Bank's internal controls or in other factors that could significantly affect internal controls subsequent to the date the Corporation carries out its evaluation.

## **PART II - OTHER INFORMATION**

### **Item 1. Legal Proceedings**

In the course of its operations, Monarch Bank and its subsidiary are not aware of any material pending or threatened litigation, unasserted claims and/or assessments through March 31, 2005 or subsequent thereto.

### **Item 2. Changes in Securities**

None.

The Bank is subject to certain restrictions imposed by the reserve and capital requirements of federal and state banking laws and regulations.

### **Item 3. Defaults Upon Senior Securities**

Not applicable.

### **Item 4. Submissions of Matters to a Vote of Security Holders**

None.

### **Item 5. Other Information**

None.

### **Item 6. Exhibits and Reports on Form 8-K.**

#### **a. Exhibits**

Exhibit 11 – Refer to EPS calculation in the Notes to Financial Statements

Exhibit 31.1 – Certification of CEO pursuant to Rule 13a-14(a)

Exhibit 31.2 – Certification of Principal Financial Officer pursuant to Rule 13a-14(a)

Exhibit 32.1 – Certification of CEO pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Exhibit 32.2 – Certification of Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

#### **b. Form 8-K.**

Form 8-K filed January 21, 2005 to announce the Bank's quarterly and annual financial performance

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**MONARCH BANK**

-----  
William F. Rountree, Jr.  
President & Chief Executive Officer

Date: May 11, 2005

-----  
Brad E. Schwartz  
Executive Vice President & Chief Financial & Operating Officer

Date: May 11, 2005

**SECTION 302 CERTIFICATION**

I, William F. Rountree, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Monarch Bank;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:
  - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - (b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - (a) all significant deficiencies in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 11, 2005

\_\_\_\_\_  
William F. Rountree, Jr.,  
Chief Executive Officer

**SECTION 302 CERTIFICATION**

I, Brad E. Schwartz, certify that:

2. I have reviewed this quarterly report on Form 10-Q of Monarch Bank;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:

(a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

(b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

(a) all significant deficiencies in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 11, 2005

\_\_\_\_\_  
Brad E. Schwartz  
Executive Vice President & Chief Financial & Operating Officer

Exhibit 32.1

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q of Monarch Bank (the "Bank") for the period ending March 31, 2005 as filed with the Federal Reserve Bank on the date hereof (the "Report"), I, William F. Rountree, Chief Executive Officer of the Bank, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 11, 2005

\_\_\_\_\_  
William F. Rountree, Jr.,  
Chief Executive Officer

Exhibit 32.2

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q of Monarch Bank (the "Bank") for the period ending March 31, 2005 as filed with the Federal Reserve Bank on the date hereof (the "Report"), I, Brad E. Schwartz, Executive Vice President and Chief Financial Officer of the Bank, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 11, 2005

\_\_\_\_\_  
Brad E. Schwartz  
Executive Vice President and Chief Financial & Operating Officer